Historic, archived document

Do not assume content reflects current scientific knowledge, policies, or practices.

Reserve
A280.29
F22G

U. S. DEPT. OF AGRICULTURE
NAT'L AGRIC. LIBRARY
JUN 18 1964
CURRENT SERIAL RECORDS

IMPROVING Management of Farmer Cooperatives

General Report 120

Farmer Cooperative Service

U.S. Department of Agriculture

June 1964

The Farmer Cooperative Service conducts research studies and service activities of assistance to farmers in connection with cooperatives engaged in marketing farm products, purchasing farm supplies, and supplying business services. The work of the Service relates to problems of management, organization, policies, merchandising, product quality, costs, efficiency, financing, and membership.

The Service publishes the results of such studies, confers and advises with officials of farmer cooperatives; and works with educational agencies, cooperatives, and others in the dissemination of information relating to cooperative principles and practices.

Joseph G. Knapp, Administrator
Farmer Cooperative Service

CONTENTS

	Page
Highlights	iii
Setting of cooperative management	1
Need for sound management	2
Legal framework	2
Principles for managing cooperatives	4
Principles of cooperation	4
Management principles	5
What it means to manage a cooperative	6
Management explained	6
The role of management	7
Management functions	8
Planning	8
Organizing	9
Directing	9
Controlling	10
Divisions of responsibility in management	10
Members	12
Board of directors	13
Hired management	15
Rules for dividing responsibility	17
Tools and techniques for managing	19
Accounts	19
Balance sheets	20
Operating statements	20
Functional accounts	21
Special accounts for cooperatives	22
The external audit	22
Budgeting	23
Operating budgets	23
Budgets for decision making	24

Page

Areas of management ---------- 26
Financial management ---------- 26
Capital needed ---------- 27
Kinds of capital and capital structure ---------- 27
Sources of capital ---------- 28
Analyzing soundness ---------- 30
Analyzing performance and efficiency ---------- 31
Analyzing uses of capital ---------- 32
Guides for a balanced program ---------- 33
Working with people ---------- 34
Employees ---------- 34
Members ---------- 37
The general public ---------- 39

Management evaluation and improvement ---------- 41
Evaluating management ---------- 42
Improving management ---------- 43
A final check for good performance ---------- 47

HIGHLIGHTS

This publication shows how management principles apply to local cooperatives and how they can be used to manage cooperatives successfully. It is intended specifically for managers (together with key employees) and directors of these associations.

An incorporated cooperative has the legal status of a corporation, and this fact has an important bearing on how management should function. Boards and hired management need to become familiar with management responsibilities that legally are theirs. Studying articles of incorporation, bylaws, and the incorporating statute will help to familiarize them with their legal responsibilities.

Principles useful in managing cooperatives are classified into two groups: (1) Principles of cooperatives, and (2) principles of business management.

Management is the act of combining such things as ideas, processes, materials, facilities, and people to produce and market products or services. It is considered here from two viewpoints: (1) Functions encountered, and (2) people involved.

Management functions defined and explained are: (1) Planning, (2) organizing, (3) directing, and (4) controlling. Emphasis is given to the part each function performs in the total management process. Illustrations also show how these functions relate to the job of managing cooperatives.

The cooperative management team comprises three parts: (1) Members, (2) a board of directors, and (3) hired management. Specific responsibilities are suggested for each part of the team.

Questions often arise as to how hired management (together with other key employees) should share management responsibilities. For this reason the study carefully considers the hired management-board relationship. Several rules have been developed and are included as guidelines to help resolve such questions. They are the time-period rule, the idea-versus-action-decision rule, the trusteeship rule, the control rule, and the staffing rule.

The report also considers tools and techniques that can help managers and directors put management principles into practice. It examines several of these tools and techniques and gives suggestions for performing different management functions. Included in the tools are records and accounts, budgeting to meet various management needs, and the external audit.

Although managers and directors cannot be expected to possess skills needed

to handle these tools, they should at least have a general knowledge of them and know what each can accomplish in management.

Management must perform its function in areas where problems need to be solved. It pays special attention to the steps managers and directors may take to analyze association finances, and provides guides for a balanced financial program. Managing finances is a critical area for most cooperatives.

Another area in which cooperative management must function is working with people. Here management must work with three groups, each of them requiring a different kind of consideration. Hence the study takes into account special management problems cooperatives encountered when dealing with employees, members, and the general public and makes suggestions for coping with them.

Finally, those responsible for managing cooperatives must evaluate how well their association is functioning to improve any weaknesses. A worksheet is presented to aid in making the evaluation. Ways to improve a local association's management also are suggested.

Improving Management of Farmer Cooperatives

by Milton L. Manuel[1]

This publication deals with a critical aspect of cooperative business activities -- cooperative management. Because management staffs are busy, material in this publication is in as brief and concise form as possible.

Even though written primarily as an introduction to cooperative management, the publication also should be of value to those having knowledge of the subject because it deals with fundamentals. It does, necessarily, omit some aspects important to management. If the ideas included are conscientiously applied, however, it will improve the management of cooperatives.

The objective of this publication is to show how management principles apply to local cooperatives and how those principles can be used to achieve success in managing cooperatives. It is concerned with those general areas and functions of management common to cooperatives of all commodity and functional types.

It is intended specifically for managers, together with key employees, and directors of local associations. A local association is one that has sole authority and responsibility for its own management. However, this publication may also be useful to other cooperatives.

The footnotes are used throughout to guide interested readers to sources containing helpful additional details on managing cooperatives.

SETTING OF COOPERATIVE MANAGEMENT

Management is the act of directing affairs. The term is used here in the sense of taking charge of cooperatives' business affairs.

It frequently is said that cooperative management is confronted with more problems than management of ordinary business corporations with comparable activities. This statement is based upon the premise that cooperatives have all the usual problems of ordinary businesses plus those that stem from their cooperative nature. For example, cooperatives face a special kind of human

---

Note: The author wishes to acknowledge the many helpful suggestions of Farmer Cooperative Service staff members.

[1]Mr. Manuel, Professor of Agricultural Economics at Kansas State University, Manhattan, Kans., took leave from the University to prepare this publication as a staff member of Farmer Cooperative Service.

relations problem in dealing with member patrons.

Management of other business corporations likely would argue this statement by citing the extra complicating features of their businesses. However, both cooperative and other business management would probably agree that their management tasks do differ and that their basic differences must be recognized and understood.

A step toward sound cooperative management is understanding the nature and objectives of cooperatives. The setting in which cooperative management functions also must be understood if the cooperative is to be successful.

Need for Sound Management

How often have you heard someone say, "Cooperatives must be well managed," or "There must be good management if cooperatives are to succeed"? You likely have heard such statements so often they seem a bit trite.

This is because such statements actually say very little. "Well managed" and "good management" are vague terms and do not contribute much. However, having high-caliber management in cooperatives cannot be overemphasized.

A 1943 study provided information on the importance of sound management.[2] "Difficulties in the field of management" was cited more often than any other cause of discontinuance in over three-quarters of a century of experience.

The answers in this study were based upon opinions, and in some cases the true underlying reasons might not have been revealed. But the frequency of the management-difficulties answer and the fact that all answers were supplied by those closely associated with cooperatives suggest that management failure was a chief cause for the discontinuance of those associations.

The experience of Farmer Cooperative Service has demonstrated the importance of management in operating farmer cooperatives. Competent management has often made the difference between success and failure in cooperatives of the past.

It can be expected to become even more important in the future. Today's farmer cooperatives are themselves becoming larger and more complex businesses. The rapid changes taking place in agriculture are causing changes in the operation of these farmer-owned undertakings.

Businesses with which cooperatives deal also are undergoing vast changes in size and complexity. In many instances taxes and other Government regulations place increased responsibilities on cooperative management.

Legal Framework

The term "corporation" as it relates to a cooperative is frequently misunderstood. If a cooperative has been incorporated, it has the status of a corporation just as any other incorporated business.

[2] Cochrane, W. W. and Elsworth, R. H. Farmers' Cooperative Discontinuances. Misc. Rpt. 65. Farm Credit Administration, U.S. Dept. of Agr. June 1943.

Incorporation is the act of creating a corporation by meeting conditions prescribed by the authorizing statute. Although some exceptions do exist, most cooperatives are incorporated under State statutes. Every State now has one or more statutes designed specifically for the incorporation of cooperatives.

It is essential that everyone connected with the management of a cooperative be aware of his association's legal form of business. Laws specify areas of responsibility and procedures to be followed for managing different forms of business. Nearly all farmer cooperatives are incorporated. For this reason, the discussion here will be limited to management information applicable to the cooperative corporation.[3]

There is something unique about the creation of a corporation. A legal person (the corporation) has been created. It is separate and distinct from members and officers of that corporation. It can possess rights to do things such as own property, buy and sell commodities, produce goods and services, and make contracts.

Care must be taken that provisions of the law are met and authorizations are not exceeded. Compliance with the law also is required for continuance of the cooperative corporation.

Matters of a legal nature are technical. The counsel of a qualified lawyer is needed for matters such as incorporating, adopting or amending articles, adopting or amending bylaws, and negotiating contracts (whether with members or other parties).

Cooperative management should be aware of its responsibilities in legal matters. The cooperative corporation has economic functions to perform in a legal and institutional framework of laws and regulations. To comply, cooperative management must file periodic reports, call and hold meetings for directors and members, keep minutes of official meetings, maintain records, and do such other things as may be required.

Those in positions of responsibility in management, especially boards of directors and executives, should become familiar with their legal responsibilities. This can be done by studying: (1) Articles of incorporation (sometimes called the charter); (2) bylaws; (3) marketing agreement (if any); and (4) the incorporating statute.

Articles of incorporation probably are the most important legal document of the cooperative. They contain statements of the cooperative's purposes and powers.

Bylaws are rules which have been adopted for governing internal operations of the association. The marketing agreement may be considered as an extension of the bylaws. It is a special contract between the association and the member, which becomes valid only when legally executed. It usually includes specific details of the duties and responsibilities of all parties to the contract.

Managers and boards must be well informed on at least the first three of these legal documents. In addition, at least one person involved in management affairs should know about the provisions of the incorporating statute. Often legal

---

[3]For more details on legal aspects, see: Hulbert, L. S. and Mischler, Raymond J. Legal Phases of Farmer Cooperatives. Bul. 10. Farmer Cooperative Service, U.S. Dept. of Agr. January 1958.

authority is drawn from general corporation laws of the State for eventualities not covered in the cooperative statute. Therefore, some knowledge of the applicable parts of general corporation laws is necessary.

Ultimately cooperative management has responsibility for meeting all legal requirements. To meet this responsibility, managers and boards need a good general understanding of legal matters and they should not hesitate to seek legal counsel when needed.

Principles for Managing Cooperatives

Fortunately much of the total job of management can be simplified by using "principles" to specify the conditions under which a given thing will cause a desired result.

These principles for assisting management are important for at least two reasons. First, much of the trial and error that would be present if no principles were available is eliminated. Second, their implication for management training is profound. Principles which underlie successful business management can be learned and applied by others.

Of course there is more to management than learning principles and understanding when they are to be applied. Emphasis here is placed upon the fact that much of management can be reduced to scientific principles.

Principles of Cooperation

The principles cooperative management needs are the so-called "principles of cooperation." These determine the framework of cooperative activity. Management must realize they are fundamental to cooperative business activities, because in many instances they modify the management principles.

Much has been said and written about cooperative principles -- their definition, their development, and their impact. This brief discussion, therefore, will limit itself to those principles believed absolutely essential to the cooperative form of business.

Most authorities agree that three principles of cooperation are basic. They are: (1) Democratic control by member patrons; (2) service at cost for members; and (3) limited returns on equity capital.

The first principle, democratic control by member-patrons, is a basic ingredient for a successful cooperative. Its primary requirement is that members using services of the cooperative shall control it democratically.

Naturally, much importance is attached to the meaning of "democratic." Here it implies equality among members from the standpoint of having a voice in affairs of the association. It also implies that the cooperative is an association of people receiving a business service and not an institution for accumulating wealth. It denotes a personal relationship between the member and his cooperative. Furthermore, it suggests that members have a voice in affairs of the association as users and not as investors.

The second principle, service at cost, states that services be performed for member-patrons at the lowest cost required to perform them. Therefore, the cooperative becomes an agency that

performs services for members without profit to itself as a business.

This second principle reveals a closely integrated relationship between the cooperative and its members' farming activities. To carry out this principle, operating procedures are needed (1) to set charges equal to costs; (2) to distribute any margin in excess of costs on a patronage basis (patronage refund); and (3) a combination of (1) and (2).

The third principle, limiting the role of capital, actually is a safeguard to insure the proper functioning of the other two principles. Capital is a necessary resource. Placing limits on its role makes sure that the amount invested does not determine the extent of a member's participation in the business activities of the cooperative and is not the basis for sharing benefits. For only by limiting the amount paid on equity capital (such as capital stock) is it possible to return any surplus as patronage refunds and thereby achieve a bonafide service-at-cost operation.

Sometimes members are permitted more than one vote, as in the case of patronage voting. But variation in voting stems from differences in patronage and not from differences in capital investment. Thus, contrary to ordinary business corporations, the amount of control in cooperatives is not necessarily related to the amount of invested capital.

These three principles are basic to cooperatives.[4] Rights of ownership, control, and benefits are identified with them.

[4]For more information on cooperative principles, see: Fetrow, W. W. Three Principles of Agricultural Cooperation. Educ. Cir. 13. Farmer Cooperative Service, U.S. Dept. of Agr. revised 1958.

Successful cooperation requires a kind of thinking that is impossible to convey completely in three briefly stated principles. Deeply ingrained in this thinking is the idea of the worth of the individual cooperator as a person -- often expressed with the statement that a cooperative is in reality an association of persons.

In the association, inter-relationships among members are based upon equitable and fair treatment for all members. Many refer to the cooperative as an economic democracy. Another basic idea which permeates cooperative thinking is that cooperative business activity is a means to an end and not an end in itself.

This idea implies the cooperative's value is based on the extent to which it can make an economic contribution to members' farming operations by stabilizing or increasing net farm income. This idea often enables a cooperative to initiate changes which result in additional benefits to members.

Management Principles

Cooperatives, just as other kinds of businesses, face problems in carrying on their operations. Much of the task of management is to solve problems as they arise and to make decisions which will best accomplish the cooperative's goals.

Problem solving has four steps:

1. Define the problem.

2. Determine ways to solve the problem.

3. Choose the way most consistent with the association's goals.

730-650 O - 64 - 2

4. Evaluate effectiveness of the way chosen.

Principles are the guides to help management solve problems. Since every cooperative is involved in economic activities of one kind or another, economic principles are needed. They state the conditions under which the greatest or the least results may be obtained.

Economics is a science concerned with decisions of choice between two or more alternatives in the use of scarce resources. For example, every business has the basic problem of producing a given amount of goods and services (output) with the least amount of expenditure (input). Usually this problem takes the form of determining the level of production that will be best for the cooperative and ultimately for its members.

Another part of this overall management problem is finding the most advantageous combination of activities. Assume an association that merchandises and stores grain, handles feeds, and merchandises petroleum products. Its management must decide how scarce resources, like capital, labor, and facilities, can be best allocated to these activities in order to get the largest possible benefits for its farmer-members. These are economic problems, and economic principles are available for solving them.[5]

Listing and developing useful economic principles for cooperative management are beyond the scope of this publication. However, cooperative management should be aware of at least the basic elements of economic principles and recognize their importance in successfully managing a cooperative.

Still another set of principles is available to assist cooperative management. These are called "principles of management." They might be considered as rules of action for organizing and operating businesses systematically and efficiently.

Principles of management which are especially important for cooperative management are given special treatment later in this discussion. They have a practical value because they have been developed from experiences of a wide variety of businesses operating under varied economic and geographical conditions.

WHAT IT MEANS TO MANAGE A COOPERATIVE

An essential part of improving management is understanding the meaning of management more fully and what it involves.

Management Explained

Management is the act of combining such things as ideas, processes, materials, facilities, and people to produce and market products or services. "Combining" is a key word of this definition. Just how and when these items are combined constitutes an important part of the

[5]For a discussion of economic principles useful in managing cooperatives, see: Phillips, Richard. Managing for Greater Returns in Country Elevator and Retail Farm Supply Businesses, Chapter II, Farmers Grain Dealers Association of Iowa, Des Moines, Iowa, 1957.

subject of management. In addition, note that the term is a broad one because it encompases all steps from the initial one of securing needed resources to the ultimate one of marketing whatever is produced.

There are two ways to look at management in business. One is to look at what management does; that is, the functions encountered in operating a business. The other is to look at who management is; that is, the people involved in running the business.

Both views will be considered here. Functions encountered are discussed first. Later the division of responsibilities, which deals with the who aspect, will be analyzed. It is especially important for cooperatives to recognize that "to manage," or "management," means more than what a hired manager does. The terms include the total management process, only part of which is the responsibility of the manager.

Also important to the meaning of management is understanding that management skills require more than experience and ability in specialized areas of the cooperative. Additional skills are needed to carry out the functions of management and to work out the relationships among those involved in the total management process.

Often a former technician, such as a plant foreman or bookkeeper, is employed as general manager. Before he can develop into a capable manager, he must realize his new job requires more from him than a knowledge of technical skills.

As a manager, he will perform management functions that require special management skills. He, with others who are responsible for management, must set goals, plan for the future of the cooperative, organize and direct the work of others, supply leadership, and establish controls to check results.

The Role of Management

Briefly stated, the role of management is seeing that the cooperative succeeds. Management is the decision-making element of the cooperative, and it solely is responsible for formulating policies and guiding the execution of those policies.

An activity may be called successful if it achieves two closely related objectives: (1) To succeed in an economic or business sense, and (2) to succeed as a cooperative.

To evaluate the economic success of a cooperative, care must be taken to analyze transactions in their entirety. The net effect of the cooperative activity must be coupled with the net effect on the farm to assess the cooperative's full contribution.

For example, assume a grain association markets grain for members and has net savings of 5 cents a bushel. To determine total returns, the 5 cents is added to the initial price the farmer received for his grain. Only by comparing total returns with the current market price can the real economic contribution of the cooperative be measured.

Cooperatives handling supplies or performing related farm services can use the same measurement.

Often the economic benefit of a cooperative is difficult to assess, especially

for intangible benefits like developing bargaining power. But the economic value always must be determined in terms of net economic benefit to members' farming activities.

Because economic conditions usually vary from year to year, the economic success of a cooperative should be evaluated over a span of several years. An evaluation over 3 or more years normally yields a dependable estimate of the economic success being achieved.

It is possible for an association to succeed in an economic sense, yet fail as a cooperative, because, to succeed as a cooperative, the association must observe specified conditions of member control, use of capital, and distribution of net savings.

Cooperative management should recognize the necessity of success in cooperative features as well as in business features. Skillful cooperative management evaluates policies and procedures in terms of how effectively they accomplish both objectives of cooperatives.

Management Functions

As stated earlier, one way to define management is to see what management does. This leads us to the so-called "management functions."

These functions are the activities engaged in when the true role of management is being performed. One must be careful not to assume that all things done by management necessarily fall in this category since in practice some may be of a nonmanagement nature.

For example, a manager may occasionally help other employees load a feed truck or may make bookkeeping entries in the association's books. These would not be true management functions even though they were performed by the manager.

When determining management functions, the total area of management responsibility is divided into a number of subdivisions. Authorities do not agree completely as to the number and makeup of these subdivisions. However, the important thing to remember is that the subdivisions should be logical units and that the entire area of responsibility should be covered.

This publication defines and briefly discusses the management functions of planning, organizing, directing, and controlling. It is important to understand each function and to see how each performs as a necessary part of the total management process. The division of responsibility for members of the management team in carrying out management functions is discussed later.

Planning

Planning is the thinking, judging, and deciding function of management. It is basic in the management process because it precedes any course of action. Whenever alternatives exist, there is an opportunity to use the planning function.

It may be regarded as the thinking-through process for choosing the alternative that will best achieve the association's objective. Sometimes it is said that planning is the job of making things happen that otherwise would not occur. It is important to understand that the planning function is the preparation for

work, and not the actual performance of the work itself. It stands to reason that the better the planning, the better the following action will be.

For example, an association may engage in planning, if it considers changing its policy for pricing goods or services. The planning process would involve suggesting and thinking through several alternative pricing plans. Each would be judged in terms of its economic effect upon the cooperative and its members.

Each plan would be evaluated, also, to determine if it was consistent with sound cooperative principles. The final step would be to choose the pricing policy which would most likely help the cooperative meet its objectives.

Organizing

A second management function is organizing, which means the grouping of activities and the structural arrangement of persons, facilities, and equipment. Once the planning function has been completed, resources must be assembled to carry out the plans. Personnel must be hired, facilities and equipment procured, and systems established to perform the business services intended.

It is obvious that the kind of grouping and arrangement of resources is vital to a successful cooperative. As cooperatives grow larger and their activities more complex, organization also becomes even more important.

For any given cooperative, various organizational structures are possible. Each will have its advantages and disadvantages. It is the task of management to analyze the different possible organizational structures and to select the one that promises the most help to the cooperative in accomplishing its objective.

For example, assume the sales of a given line of supplies have increased and management has decided to establish a new department to handle those items. A new arrangement of personnel will be required. Assume the chief executive (possibly together with the board) hires someone to take charge of the newly created department. New lines of authority and new job descriptions will be needed to reflect the changes in the organizational structure.

To make these changes, management involves itself in the organizing function. Here activities are grouped in a department, and a structural arrangement is established between employees. In addition, employees are related to facilities and equipment.

Directing

Directing logically follows planning and organizing. It is the management function that deals with the day-to-day execution of detailed activities. Emphasis is placed upon supplying the instruction necessary to get things done. Directing is the process of telling employees what to do and when to do it.

The terms "guiding" and "overseeing" most fully express the real meaning of directing. Management must explain assigned tasks to employees by any appropriate teaching methods.

Another responsibility which must be borne by management is coordinating the total business operation. Some management authorities feel coordination is sufficiently important and distinctive to be

classified as a separate management function. Here it is treated as a part of overall directing.

Coordinating means integrating activities, people, facilities, and equipment to achieve a satisfactory unified operation. The objective of coordination is for each unit to help other units as much as possible and yet avoid conflicts.

Proper organizing creates a framework within which business services can be provided. Detailed instructions must be given by those in charge to those employed to perform certain tasks.

For example, assume the plant foreman of a grain elevator has been directed by his supervisor to load a car of grain for rail shipment. The supervisor would need to give clear and specific instructions as to what grain was to be loaded and when it should be ready for shipment, together with any other details essential for completing the job.

Coordination would be needed to insure that some other activity did not conflict with the equipment or personnel needed to load the grain.

Controlling

The fourth management function is controlling. It may be defined as acts that check results being achieved to insure that plans of action are being carried out as intended. A logical second part of controlling is taking necessary remedial action to prevent unwanted results.

In a sense controlling might be considered as a followup for planning, organizing, and directing. Several steps are implied. First, management must determine the results achieved. Second, management must evaluate these results. Third, management must correct any plans that went astray.

When properly carried out, controlling can be expected to accomplish the following: (1) Prevent unauthorized action, (2) predict trends and forecast results, and (3) help management evaluate performance of employees and the business as a whole.

Many of the essential elements of the control function can be illustrated with the external audit, which is more fully explained beginning on page 22. An audit is made by an independent auditing firm to get an unbiased report of the cooperative's financial condition. By analyzing accounts and reports, auditors develop the means for evaluating past operations. These data help management appraise the effectiveness of current policies.

For example, the audit would show management how effective present policies have been for controlling accounts receivable. If those policies were not getting desirable results, then policies could be modified to improve the control over them.

DIVISIONS OF RESPONSIBILITY IN MANAGEMENT

Heretofore we have been concerned with fundamental aspects and the cooperative and corporate setting in which cooperative management functions.

Management also has been considered as a total unit. Nothing has been said as to who will shoulder management duties.

Let us now consider the "who" part of management. Those with management responsibilities in cooperatives are a team made up of three parts: Members, board or directors, and hired management. Some important relationships among elements of the team can be illustrated with a pyramid such as that shown in figure 1.

Here the pyramid depicts the total responsibility of management which must be handled by elements of the management team. Members make up the base of the pyramid. Aspects of management which they must furnish are basic in the total management process. Therefore, members are shown as the foundation in the illustration.

Members elect a board of directors to represent them in most phases of management. Note in the diagram how the directors' sector rests upon the foundation of members. The base for directors is narrower than that for members, suggesting that duties and responsibilities of boards of directors stem from members.

Hired management make up the apex of the pyramid illustration and often are called the spearhead of management. Their management authority is delegated to them by the board. Hired management's responsibility is derived from that responsibility vested by members in the board of directors.

The space occupied by each element of the team in the illustration is not intended to suggest actual proportional

Fig. 1--The Cooperative Management Team

shares for each in the management process. Instead the pyramid is designed primarily to show relationships.

A dotted line has been used separating the three elements of the management team. This kind of line is symbolic since in practice no hard and fixed line of demarcation can be drawn between areas of management responsibility. Some responsibilities can be stated in a positive manner while others must be established by agreement.

In the illustration the board separates members from hired management. It is basic in cooperative management that this be so. Only chaos would result if hired management were required to take instruction directly from members. Hired management is responsible to the board, while the board is answerable to members. This procedure is based upon a logical chain of command to avoid conflicts and confusion.

Successful management of a farmer cooperative is the result of effective teamwork of all three parts of the team -- members, the board, and hired management.

Members

Members of a cooperative have a role in management which differs from that of stockholders in ordinary business corporations. This is true because they own and control the cooperative. Its primary function is to perform needed services for its members.

Members, therefore, should be intimately and personally related to affairs of the cooperative and should have a positive role in its management. The basic nature of members' role has been illustrated in figure 1.

Experience has shown that often members do not automatically assume their responsibilities. Boards of directors and executives have responsibility for helping members understand their role in management. They must devise means and furnish opportunities for members to express needs and desires that are pertinent in managing their cooperative.

Here is a list of management responsibilities which ordinarily must be assumed by members if there is to be an effective cooperative.

1. Adopt and Amend Bylaws.--Since bylaws are the rules covering internal operations of the cooperative, members have a major management responsibility in analyzing and approving fundamental policies which become a part of bylaws.

2. Select a Competent Board of Directors.--A cooperative is a democratically controlled form of business. However, members cannot make all decisions directly. In carrying out democratic control, members elect directors to represent them in many affairs of management.

This is a member's right and it should not be taken lightly. Often the competency of the board depends directly upon the wisdom and judgment exercised by members in electing directors. Members should understand and evaluate board actions and stand ready to remove any directors who are not carrying out responsibilities entrusted to them.

Obviously, members must exercise sound judgment and avoid unnecessary harassment of directors. To a large

degree the extent to which any cooperative will be controlled by members is determined by the actions of those who serve on the board of directors.

3. Study Issues and Cast an Informed Vote.--By virtue of the democratic nature of cooperatives, every member is entitled to vote. This voting privilege carries with it a responsibility to vote and to do so intelligently. It requires that members be well-informed and attend meetings to express their views.

Opinions will vary concerning the extent to which proposed policies should be taken to members for their vote. Usually it is desirable that members directly determine basic policies affecting members. Examples might be: (1) Major expansion in facilities, (2) changes in capital structure, especially when investment by members is involved, (3) adoption of a marketing contract, and (4) major change in kind of service offered.

The basic nature of members' role can be demonstrated by pointing out that their vote is important for establishing the cooperative. Also, most States require members' vote for discontinuing the association.

Ultimately, members are responsible for the character of the cooperative's management. They stand to benefit directly from good management, and results of poor management will fall directly upon them.

Board of Directors

This group occupies a key role in the management of cooperatives. As shown in figure 1, directors have a position between members and executives. State statutes vary but usually one must be a cooperative member to be eligible for election to the board. This is an important requirement since board membership then automatically is limited to the association's members.

The board is elected by members to represent them in certain phases of management. It is unique in cooperative organization that the board represents members as users of cooperative services, not as capital investors. This distinction is important. In cooperatives a different kind of managerial responsibility is placed on directors than is placed on directors of other kinds of business.

Cooperative directors must keep informed of services needed by members and work conscientiously to provide them in an efficient manner. They need to emphasize cooperative activities most beneficial to members' farm businesses. This emphasis is quite different from one that stresses returns on capital investment.

Laws governing cooperatives recognize definite managerial responsibilities for directors. All corporate powers of an association, other than those specifically conferred upon members, are vested in its directors. In general, it is the function of directors to direct and supervise in a fundamental way the activities of the association.

Directors discharge their duties in two ways. One is handling their duties directly as a board. Here they deliberate, make decisions, and give instructions as a unit, not as individual board members. The other is delegating duties to executives. Here is a list of management responsibilities that ordinarily are handled directly by the board.

730-650 O - 64 - 3

1. Function as Trustees.--A primary role of directors is to perform as trustees for the members they represent. Essentially they are custodians and are charged with safeguarding and managing assets entrusted to them. Their responsibility is to act in the interest of all members and not on their own behalf.

2. Determine General Policies.--Setting long-run objectives and making long-range plans clearly is another task of directors.

The board, representing their members as patrons, must anticipate future needs of members and explore the economic feasibility of supplying those needs through the cooperative.

The board must take a major role in making long-range plans, if the cooperative is to serve the real needs of farmer members as they change with changing agricultural conditions. It might seek the counsel of others but it cannot shift its responsibility to others.

3. Preserve Cooperative Character.--Earlier it was emphasized that cooperative management has a role of insuring that the association will succeed as a cooperative.

This is a board responsibility for two reasons. First, it is a matter of general policy. Second, it is implied in the trustee role of the board of directors that the cooperative character of the association be preserved and even strengthened when necessary. Undoubtedly many aspects of carrying out such policies would be delegated to the manager but it is clearly the board's responsibility.

4. Employ a Competent Manager.--This undoubtedly is the most serious responsibility of the board, since success or failure might hinge on how well the board handles this function. Having employed a manager, the board must set clear-cut policies for the manager to follow. While delegating duties to the manager, the board also must delegate sufficient authority for him to carry out these duties.

5. Require Accounts and Records.--Details would be delegated to the manager, but it is the board's responsibility to insist that an adequate bookkeeping system be established and maintained.

The board must also insist on regular external audits of the accounts. Then it needs to arrange for a presentation of the audit results to members, which usually is done at the annual meeting. In a sense, the board thereby reports directly to members on the financial status of their cooperative. Initiating an audit is a trustee role, a management responsibility of the board, and is not a responsibility of the manager.

6. Control the Total Operation.--This is related to the board function of maintaining accounts and requiring audits. However, it is more fundamental. Control is a basic function the board must supply. Directors are responsibile for seeing that established policies are followed and that desired results are achieved. If farmer cooperatives are to be operated in the best interests of their members, the board must function forcibly in its control responsibility.

7. Distribute Corporate Earnings.--Bylaws should indicate clearly ownership of net savings and how they are to be distributed. Some might accrue initially to the cooperative corporation; others will accrue directly to members as patrons.

The board, acting as official trustees of the cooperative corporation, has the responsibility of distributing net savings accruing to the cooperative corporation. Examples would be the distribution of stock dividends and allocation of some of the savings to corporate reserves, when authorized.

It is imperative to recognize that a board of directors is a plural executive that must function as a committee. Activities of any board member become official only when he acts through the group.

It has been pointed out by authorities that the board carries out its functions by using three main procedures.

1. It makes original decisions in the area of its responsibility.

2. It confirms decisions made by executives (and possibly board committees). The board may also help executives by counseling them before decisions are made.

3. It reviews reports, programs, and activities of executives.

Hired Management

This part of the cooperative management team might be called "manager" but actually includes more. The term, "hired management," is used to include the manager together with other key personnel that are delegated management functions.

For example, assume a cooperative, organized into three departments, has a person in charge of each. Ordinarily the manager will delegate management responsibilities to the three department heads.

Few would question the importance of hired management in performing the management function. Occasionally some go to an extreme of regarding the manager and management as being the same. This kind of thinking is useful in emphasizing the crucial nature of hired management to the success of an enterprise. However, such thinking is not sound for cooperative management, since members and the board of directors also have major management responsibilities.

As illustrated in figure 1 on page 11, hired management makes up the spearhead of cooperative management. This is symbolic since they must be out in front and provide overall leadership. Leadership means not only doing things in a forceful, effective, and timely manner; it means inspiring and bringing out the best in others as well.

Managers must know their own managerial responsibilities and also be familiar with managerial responsibilities of others as well.

Sound cooperative procedure requires that hired management have certain definite management responsibilities. Following is a list of those ordinarily believed to be their job:

1. Direct Business Activities.--This may appear to be contradictory since one may assume all directing is done by directors. However, the board does not direct in this sense. Hired management direct when they regulate operations of the business and the conduct of other employees. They also direct when they guide, instruct, and give orders. A manager, for example, directs a cooperative much as a conductor directs an orchestra. He is in charge of specific and detailed operations of the organization.

2. Set Goals and Make Short-range Plans.--Hired management's responsibility also includes setting goals and making plans. Steps must be taken to carry out general policies that have been laid down by the board. In turn, a manager finds it necessary to set goals and to make his own plans for achieving established objectives.

3. Organize and Coordinate Subordinates and Activities.--Hired management is chiefly responsible for the internal organization of the business activity. A logical structure must be developed as a framework for performing functions of the association. It is the manager's task to develop that structure and to relate employees to appropriate assignments within the structure.

Since organizational structure is closely related to goals and policies that are the board's responsibility, the manager must work closely with the board in this area. However, the manager must take the initiative.

Coordination may be considered a part of organizational structure. It is essential that activities of component parts of the cooperative -- for example, of departments -- be synchronized. The manager's job is to achieve coordination among employees and to insure that everyone works harmoniously toward common goals of the cooperative.

4. Control.--The manager's job includes responsibilities of control. These may be divided into two kinds: (a) Controls to carry out instructions of the board, and (b) controls initiated on his own behalf.

The manager will do such things as make forecasts, analyze alternatives, make decisions, and initiate plans based upon those decisions. He will need controls to determine the accuracy of his forecasts and to see if his plans are working satisfactorily.

An essential part of employing controls is having the information needed to make them effective. The manager and his chief assistants must have a thorough understanding of all problems facing the association and possible alternatives for solving them.

In addition, they must have detailed information about the level of performance being achieved in all areas of operation. Only by having a full understanding of the overall business can they use controls effectively to check results and to make improvements.

5. Staff the Cooperative.--The manager's position carries with it a major staffing responsibility. Some staffing is done in cooperation with the board; other staffing might be done working jointly with subordinates.

A principle of staffing is that the authority for hiring and firing employees be vested in the person or group responsible for supervising those employees. Staffing key positions is usually done by the manager with the approval of the board. It is appropriate that the manager have this power, because key positions such as department heads have definite managerial functions.

In turn, department heads should work with the manager in staffing positions in their respective departments. It is essential that responsibility for work done and authority for staffing be linked closely together.

Rules for Dividing Responsibility

The previous section cited responsibilities for each component of the management team. Those characteristically assumed by each party were included in standard situations.

Of course, in many situations exact divisions of responsibility cannot be made. Differences of opinion do exist on how they should be shared. Management responsibilities in a given cooperative also might vary, depending upon local circumstances and upon the abilities and personalities of those involved.

Employee responsibility, in a management sense, may be defined as the obligation of a subordinate to perform his duties. It denotes a relationship between one in authority and a subordinate. In essence, responsibility means obligation.

Responsibility cannot be delegated to others. For example, a manager may delegate authority to accomplish an assignment to a subordinate, but the manager cannot delegate the responsibility with which he has been charged. Our concern is to identify responsibility.

Some general rules to determine areas of responsibility appear here, not as absolutes but as guides. Experience has shown that most questions about responsibility arise between the board of directors and hired management. Therefore the rules discussed here pertain to the division of responsibility between hired management and the board.

1. Time-period Rule.--Some management decisions are made to handle matters for a short period of time, while others may be for a long period. The length of time is useful to determine areas of responsibility in cooperative management.

Long-run decisions are always made by the board. Examples are setting association objectives, making long-range plans, and establishing basic policies that are expected to prevail for several years. Making commitments which will require added facilities and staff also is the board's responsibility. Changing the financial structure is another example. Each of these decisions is characterized by its long-run nature.

Hired management also would have the responsibility for making decisions in many of these same areas but covering shorter periods of time. To execute decisions made by the board, hired management must establish goals, set policies, and make plans. If there is a question whether hired management or the board is responsible for a decision, the time-period rule may be helpful.

2. Idea- vs. Action-decision Rule.--Often decisions can be classified as those dealing with ideas or those involving actions. An idea may be defined as a mental picture of something desired, proposed or planned -- a contemplated performance. When dealing with idea decisions, one makes proposals, formulates plans, estimates probable outcome. Such activities involve ideas and not actions and are clearly the obligation of the board.

One gets into action decisions when it comes to putting idea decisions into action. Making action decisions is the responsibility of hired management.

3. Trusteeship Rule.--Many trustee functions must be performed by

management. Directors are trustees, elected to act on behalf of the interest of members. Basic decisions to safeguard property of members and to insure its use for purposes intended are trusteeship decisions and clearly are the responsibility of directors.

Therefore, the board must do such things as establish effective controls, arrange for an external audit, and determine (within limits authorized by organization papers and statutes) how cooperative savings will be distributed. The board may delegate some of its authority to hired management when carrying out its trusteeship, but it cannot shift its basic responsibility.

For example, the board may give the manager authority to purchase and keep in force insurance coverage on association property. Here it would delegate its authority but not its responsibility for maintaining and safeguarding property.

4. Control Rule.--Often questions arise about the nature of responsibility for carrying out control functions. Since hired management as well as the board are involved in control activities, some division of responsibility is essential.

Control activities may be divided into two kinds, primary and secondary. Primary controls are those dealing with long-range activities or those involving items of a trusteeship. They include controls over the manager, long-run policies, long-range financial commitments, and controls for overall performance of the association.

Secondary controls have to do with the short-run operational aspects of the cooperative. These include control over subordinate managers (such as department heads) and employees; production, marketing, and procurement activities; and office procedures.

The board must be responsible for primary controls while hired management must assume responsibility for secondary ones. Classifying controls into primary and secondary groups as defined should be helpful for determining responsibility over control matters.

5. Staffing Rule. -- Two seemingly obvious but definite points regarding staffing are: (1) The manager is employed by the board, and (2) employees having no management responsibilities are hired by the manager. However, an understanding needs to be reached for staffing many positions in the typical cooperative.

Authority for staffing must be vested in the person or group having responsibility for the work to be performed. When responsibilities are closely related, staffing should be assumed as a joint responsibility.

For example, department heads ordinarily will share managerial duties with the manager. Therefore, it is advisable for the manager to staff these positions with approval of the board. Using similar reasoning, department heads would staff their departments with the approval of the manager.

Several conditions must be met for the cooperative to have effective and efficient management.

First, each element of the cooperative management team must understand the nature and extent of management responsibilities for all members of the team.

Second, each must do his share, yet not infringe on rights and duties of others.

Third, when questions of management responsibility arise, those involved should discuss them openly and seek to arrive at logical divisions of responsibility.

Once made, decisions should be recorded and made available to all concerned. A wise procedure for handling activities of an employee is to enumerate his tasks carefully in a "job description." Similar materials, possibly in a procedures manual, should be prepared, describing management responsibilities for all members of the cooperative management team.

TOOLS AND TECHNIQUES FOR MANAGING

The discussion thus far has centered around the fundamentals of management. Let us now discuss how those fundamentals work and how they relate to cooperative management problems.

Some useful tools and techniques for managers and directors will be given. Emphasis will be placed on their description and their use in carrying out specific management functions. Detailed transactions used in employing these tools are handled by specialists such as accountants and auditors. Managers and boards cannot be expected to know how to use such tools but should be aware of what can be accomplished by using them.

Accounts

A complete and accurate accounting system is absolutely necessary for management to function properly. It does not always guarantee good management, but without it management is ineffective or helpless.

Accounts and statements enable management to determine results of past operations. They are necessary for performing all functions of management but are especially necessary in planning and controlling. Since directors have major responsibilities in these areas, they should familiarize themselves with the basic accounts and their uses.

Two aspects of accounts are important for cooperative management to know. First, it is essential that the right kinds of accounts be kept in sufficient detail. Second, management must know how to use those accounts.

Businesses with well-developed accounting systems use the double entry system. Cooperatives not using this accounting method should by all means consider changing to it.

Each entry is recorded twice; hence the name double entry. This system is especially revealing since one set of entries describes cooperative assets being used, while the other set describes financial interest in those assets.

The entries must be equal because the same amount is being described at two

different places. For example, assume members' subscribed stock and money is used to purchase propane facilities and equipment. In this case the investment would be entered in assets, while the stock entry (of a like amount) would be made in the member-equity account. These transactions would record assets acquired for use and at the same time reveal the financial amount in those assets.

Balance Sheets

Double-entry accounts are used to develop several financial statements of value to management. One is the balance sheet, a report of the cooperative's financial position.

A unique feature of this statement is that it shows the association's financial status at a stated point in time. All the various assets of the cooperative as of a given date are classified and reported together with appropriate values.

Another column summarizes financial interests in those assets. Members' ownership interests are shown as members' equity, while financial claims against assets are reported as liabilities. A basic accounting rule is this: Assets are equal to the sum of liabilities and member equities. This merely is another way of saying that all assets have financial claims against them, and they may be classified as a liability or as an equity claim.

A chief interest of management in the balance sheet stems from its usefulness in revealing changes taking place in key financial items. Changes can be observed by comparing items of a balance sheet with comparable items relating to a former period.

A balance sheet should be prepared at least annually and perhaps more often. Preparing a complete balance sheet each month might not be warranted. However, one might be prepared to draw attention to those assets that are subject to change and to those that are especially critical in the kind of business in which the cooperative engages. Accounts for these special items then could be summarized monthly. For example, a farm supply cooperative making credit sales might determine account receivables monthly but might determine fixed assets annually.

Operating Statements

The operating statement is another key statement summarized from an association's accounts. Contrary to the balance sheet, it provides an overall picture of the association's business operations for a specific period of time. Of primary interest is the operating statement's final figure reporting total net savings. Since the operating statement also contains information on sources of gross income and expenses incurred, it helps explain the size of operating results actually achieved.

Management can learn a great deal from the operating statement. It documents such items as: (1) Gross margins from sales, (2) gross margins received for other services performed, and (3) expenditures incurred in performing services. By studying these data, one can note readily how each affects final net savings.

Operating statements should be prepared monthly. A month-to-month comparison of key items tells management what is taking place in the cooperative's operations. Management might make decisions to increase or lower markups,

increase some expenditures while decreasing others, and urge changes in volumes.

Operating statements have limited value for planning and control, but when related to the operating budget their value increases greatly. A later section dealing with operating budgets explores this relationship.

Functional Accounts

Operating statements, as described, are especially useful in getting an overall view of the cooperative's operations. However, management needs more specific information and that is why functional accounts were devised.

Functional accounts (sometimes called enterprise accounts) are special statements of income and expenses that pertain to a specific line of business services. For example, assume a cooperative handles fertilizer which we will call a function. The functional account would show total fertilizer sales, cost of fertilizer sold, and the resulting dollars of gross margin.

But before management can evaluate how well the cooperative is doing in fertilizer, expenses must be determined and subtracted from the gross margin. The method used to compute the final figure in a functional account determines its future use.

Two different methods may be used to develop functional accounts. They differ as to how costs are handled and in the makeup of the final figure reporting savings. One method develops net savings, while the other develops what is called contribution income (savings).

All costs are considered in deriving net savings, including those that reasonably can be associated with the fertilizer function.

To obtain all costs for handling fertilizer, one must also include a portion of general overhead and administrative costs. This is done by allocating, on some reasonable basis, a portion of those fixed costs to the fertilizer function.

When all costs are computed and subtracted from the gross margin, the resulting figure is the estimated net savings from fertilizer.

The second method defines costs differently, and consequently the resulting savings differ from those derived by the first method.

Here only those costs that reasonably can be associated with the fertilizer function are considered. The remaining net figure then is called contribution income (savings). It is the amount of income available for contributing to other costs (general overhead and administrative) and to total net savings.

Each of the two methods has its own advantages and disadvantages.

The functional account which derives net savings for the function is designed to show the absolute level of profitability for each function. It is especially well suited for making long-term evaluations of the cooperative's various functions.

The method that computes contribution income (savings) is derived more easily and is excellent for showing the relative profitability of the various enterprises in which the cooperative is engaged.

730-650 O - 64 - 4

The chief value of functional accounts stems from the fact that cost and income data are matched by functions. Management must have knowledge of its sources of savings, costs incurred, and something about net savings being generated by functions.

Functional accounts are designed to secure these kinds of data. By studying these data, management should be able to evaluate the merits of each function and determine the contribution each is making to the cooperative's total operations. Also, these data should enable management to compare results against goals established earlier.[6]

Special Accounts for Cooperatives

Farmer cooperatives need the same kinds of records and accounts as other businesses having comparable activities.

In addition, special records are needed for carrying out functions unique to cooperatives. Special cooperative records can be classified into two kinds: (1) Those needed to achieve services at cost for members, and (2) those associated with member-patron financing.

A patronage record is a special account kept by the cooperative to show all business transactions (patronage) performed on behalf of a given patron. Each person's patronage should be subdivided and recorded by lines of business services (functions) corresponding to those used by the association in making patronage allocations.

Patronage records furnish the data needed to determine each member's pro rata share of total net savings that is available for refunding. In addition to patronage records, pooling cooperatives must provide for recording advanced payments made to members. Patronage records are needed whether an association uses the technique of pooling or making patronage refunds. Both techniques are means of making adjustments to members in such a manner that services are performed for members at cost.

A second type of record needed by cooperatives using special patron financing is often called the revolving fund plan. (The revolving fund is discussed later in the financial management section.) This financing technique is unique with cooperatives because members with capital investments obligations to finance also are patrons of the cooperative's services. Special capital ledger accounts are establisted and maintained for each patron participating in the revolving fund.

These accounts must show clearly all investments made by each patron and all amounts returned to him. Revolving fund accounts are related closely to patronage records since the annual financial investment made by each patron is related to the operations of the cooperative and to patronage of each.

The External Audit

An external audit is a periodic verification of the records of a business by an auditor independent of the business.

[6] For more information on functional accounts and mechanics of preparing them see: Dickens, Robert L. Management Accounting for Frozen Food Locker and Related Plants. Chapters II, III, and IV. AH 220. Farmer Cooperative Service, U. S. Dept. of Agr. October 1961.

Usually external audits are made by public accounting and auditing firms.

As has already been mentioned, the external audit is often called the most important tool available to directors for controlling the cooperative. Every cooperative should have an audit made of its financial operations at the close of its fiscal year. It is imperative that the audit be made at the request of the board.

It is desirable to select an auditor who is well informed about cooperatives and experienced in auditing the kinds of operations in which the cooperative is engaged.

The auditor should present his report directly to the board. In this way the board will have first-hand information that the association's records are in order or that discrepancies have been noted. As trustees of the property of others, it is essential that the board have an independent evaluation.

Equipped with information supplied by the auditor, the board can then report to members on the financial position of their cooperative.

Careful study of an audit report reveals the extent to which the manager has followed board policies, especially financial policies. It also helps the board evaluate whether the association is accomplishing its basic objectives. Although the audit primarily is a control tool, it often can be used for future planning as well.

Budgeting

Budgeting is a management tool especially valuable for planning and controlling. All cooperatives, large or small, can benefit from the basic ideas found in budgeting and budgetary control. Two main uses of budgets are considered here: (1) Operating budgets, and (2) budgets for decision making.

This discussion examines these two uses to see how they can be applied to cooperatives. The mechanics of these uses and how they may be carried out can be learned by studying references cited.

Operating Budgets

The operating statement gives management an overall picture of the cooperative's operations. Its use is limited for controlling and planning because it reports only what has happened.

There is no real opportunity to exercise control by using the operating statement, since it is too late to change what already has happened. Also, the past serves only as a guide for the future and, therefore, is of little assistance in planning. The operating statement does record actual performance but does not include a standard of comparison to evaluate that performance.

An operating budget is a management technique especially designed for carrying out planning and controlling functions. Devised to remedy the weaknesses of the operating statement in these respects, it is, in a sense, an estimated projection of an operating statement.

The operating budget is a plan of overall operations for a future period giving estimated volumes and expected income, including anticipated expenses. Whereas the operating statement covers

past operations, the budget is the equivalent of an operating statement before the beginning of the new fiscal year.

Let us now examine the operating budget's value in managing.

First, budget preparation requires planning. Management must forecast business services that members likely will need and plan how those services can best be performed. At the same time, management must set goals and make plans for achieving them.

The budget provides a framework for recording the cooperative's goals in terms of volumes, margins, costs, and net savings. The success of a budget depends largely on participation of the many people involved in the cooperative. Its preparation requires that employees make cost-and-benefit analyses and helps them to gain insights into operations that they might ordinarily overlook in day-to-day activities.

Second, the operating budget is an effective tool for controlling functions. As operations progress through the year, actual results can be checked against budget goals and any undesirable consequences can be detected as they develop.

Careful control of the budget enables management to take corrective action promptly. Therefore, the operating budget is an effective device for evaluating operations and comparing them against established performance standards.

Operating budgets can be of major assistance in planning and controlling costs and capital expenditures because, as stated earlier, service-at-cost is a fundamental principle of cooperation. But this concept is of little value unless cooperatives operate as efficiently as competitors. Careful planning helps reduce costs without impairing efficiency.

Planning often prevents duplication of effort, locates bottlenecks, and helps use labor and facilities to greater advantage. A budget enables management to pass judgment on proposed costs and capital expenditures before they are made. This is another illustration of budgetary control being excercised by management.

Who should prepare the budget in a farmer cooperative? Ordinarily the manager prepares it with the help of his staff.

Once drawn up, the budget should be submitted to directors for their examination and approval. While considering the budget, directors must keep in mind they have important responsibilities in planning and control. It is their job to see that operations are planned and controlled in the best interests of members. The operating budget is an effective device for carrying out these responsibilities.[7]

Budgets for Decision Making

Often cooperative management must make major decisions about changes in operations. Because changes are taking place rapidly in agriculture, cooperatives often are confronted with problems of dropping or adding functions. Still other management decisions may be required for changing price structures or deciding whether to rent or purchase needed assets.

[7]For more information on operating budgets and details of their preparation, see: Dickens, Robert L. Management Accounting for Frozen Food Locker and Related Plants. Pp. 100-106. AH 220. Farmer Cooperative Service, U.S. Dept. of Agr. October 1961.

The budgeting technique can be used for making decisions on each of these possible situations. It furnishes a framework for recording expected income and anticipated costs to estimate the net benefits of a change.

Budgets are especially helpful in planning because they are forward looking. Accounting data are historical, but data obtained from functional income and expense accounts are especially useful for planning future actions.

Often cooperatives find it necessary to make decisions in operations they have never experienced. Budgeting is a technique to formulate new patterns of operations and analyze the likely outcome of those particular patterns. For example, a proposed branch operation might be planned by budgeting to discover the net effect of the branch on the cooperative's total operations. Assuming that appropriate and reliable income and expense data are available, the merits of a proposed change can be tested in advance by budgeting.

A convenient feature of using budgets in planning is that they can be used to consider changes that are only being contemplated. In other words, one can get meaningful answers by confining the analysis to proposed changes. By restricting the study to the parts of the operation which contain the proposed change, much unnecessary effort can be saved.

The key to this analysis is the emphasis placed on determining the net effect of the proposal upon the cooperative. By net effect is meant the change in income offset by the change in associated costs. Management can begin by analyzing the cooperative's present operation. Then the feasibility of alternatives open to their cooperative can be studied by budgeting.

Let us consider more specifically how budgeting can be used to reach decisions. Some of the more useful concepts can be illustrated by exploring two proposals: (1) Adding a function, and (2) eliminating a function. Many management decisions facing cooperatives today fall in one of these two categories.

Adding a Function.--Essential to making this kind of analysis is acquiring the necessary data. When adding a new function is being considered, much of the income and expense data must come from outside sources, such as neighboring cooperatives, State and Federal research agencies, and accounting firms or their societies. Special care is needed to estimate probable income and expenses; and since the association is inexperienced in the new function, conservative estimates should be used.

The budgeting mechanics for adding a function are simple, once data are obtained. The approach is to estimate the expected change in income and match additional costs against that income.

A few points need to be considered about costs. Only those new costs needed to support the added function should be included. Do not consider costs of any resources on hand or those used before the new function was added.

For example, assume the new function could use existing facilities without interfering with other operations. In this situation, no costs would be entered for facilities since they were not new costs added because of the proposed new function. Of course, one must think through the proposal carefully and make certain that

all new costs do enter into the analysis.

Eliminating a Function.--Budget analysis for considering the elimination of a function differs from the approach just discussed. Most of the difference centers around the handling of costs.

A major question is how much costs would decrease if the function were dropped. Costs probably would not be reduced by an amount as large as that being charged to the function and some of the resources used by the function might be kept even if the function were dropped. For example, if dropping a function leaves one-half of a warehouse unused and there are no immediate plans to use that space, warehouse costs would not be reduced. It would be a mistake to cut out those costs from the budget merely because the function was eliminated.

This illustrates the fact that some costs currently charged to the function are not reduced by excluding the function. The costs that could be eliminated should be computed and matched against the income that would be expected from the function.

If expenses exceed income, as defined, then the function could be eliminated. Here again, the final decision must be based upon what net effect dropping the function would have upon the cooperative's total operation. The change in income caused by the action must be measured against the change in expenses resulting from that action.[8]

AREAS OF MANAGEMENT

The purpose of this section is to illustrate how management principles can be applied in areas where cooperative management functions. In reality all aspects of cooperative organization and operation concern management.

However, it is beyond the scope of this publication to discuss all areas. Instead, two key areas -- managing finances and working with people -- are singled out for special treatment. The intent is to develop only highlights of those areas as any complete treatment would require a publication for each.

For example, management cannot afford to overlook details of manager-director functions, problems of finance and of achieving coordination with other cooperatives, membership relations, public relations, and the like.

Financial Management

Financial management is a key area since nearly all aspects of the cooperative's activity are drawn together in its finances. Resources used and output produced are stated in dollars and cents and appear in financial records.

Financial management involves: (1) Considering funds available together with

[8]For more information on budgets for decision making see: Dickens, Robert L. Management Accounting for Frozen Food Locker and Related Plants. Pp. 107-117. AH 220. Farmer Cooperative Service, U.S. Dept. of Agr. October 1961.

terms under which they may be acquired, (2) allocating those funds among the assets to be financed, and (3) insuring that all aspects of financing are carried out in a manner consistent with sound cooperative principles and procedures. The latter is especially important since policies used in managing finances have a profound impact upon the cooperative character of an association.[9]

Capital Needed

The amount of capital needed varies with the kind of service performed and the manner in which it is performed. For each cooperative endeavor there is an ideal quantity of capital. An amount smaller or larger than the ideal will cause the operation to be less efficient. Usually the problem is too little, rather than too much, capital. Management should determine to the best of their ability the ideal for their cooperative. This is an urgent matter for old as well as new associations.

Insights can be gained into financial needs by using the budget techniques previously discussed. Capital is needed to finance facilities and equipment (fixed assets) and working capital (current assets). In addition, most local cooperatives are integrated in some manner with regional cooperatives. Investments locals make in regionals usually are classified as investment assets.

[9]See also Farmer Cooperative Service. Financing Farmer Cooperatives. FCS Educ. Cir. 5. U.S. Dept. of Agr. Sept. 1957, and Hulbert, Helim H., Griffin, Nelda, and Gardner, Kelsey B. Methods of Financing Farmer Cooperatives. Gen. Rpt. 32. Farmer Cooperative Service, U.S. Dept. of Agr. June 1957.

Kinds of Capital and Capital Structure

It is the task of cooperative management to see that capital requirements are met. Not only must consideration be given to the right amount of capital. Kinds of capital as well as the basic capital structure are important.

Two basic capital structures around which finances may be organized are: (1) Capital stock, and (2) nonstock. The classification is important since it denotes a kind of capital in each and also reveals the nature of members' claims to assets of the cooperative corporation.

Every association must have a legal document held by members to denote membership. The stock-type association issues one or more shares of common capital stock. Nonstock associations use membership certificates (or something similar) to denote membership in their associations. Members' ownership interests in a capital stock cooperative are determined by the relative amount of common stock owned.

On the other hand, in nonstock associations members' claims to assets of the corporation are equal. The nature of members' claims has been described as they normally exist. Other arrangements are possible when legal documents have been modified.

Cooperatives can use either capital structure successfully. Care must be taken to limit returns on capital to nominal interest rates.

Stock associations tend to vest voting rights in common stock. Therefore, policies are needed to limit the influence

of stock in voting as well as in the distribution of savings. Stock cooperatives also should have a policy of keeping common stock identified with members currently patronizing the cooperative.

All capital in a cooperative can be divided into two kinds: (1) Equity, and (2) creditor. The two differ in the nature of the financial interest the contributor has in the association's capital and in savings made in the cooperative.

Equity capital is ownership capital in a real sense. It must bear the financial risks and, therefore, often is called risk capital. Losses incurred must be absorbed by owners. Gains made over other charges and patronage allocations normally will accrue to the equity capital also.

Management should be aware of this relationship when policies are being formulated for distributing net savings. To achieve service at cost, the bulk of net savings should be distributed on a patronage basis and not be accrued as invested capital.

It is fundamental in financing that control be identified with owning equity capital. This is the reason for requiring farmer members to own a majority of equity capital, if the cooperative is to be controlled by members to serve their own needs.

Creditor capital is that being used in the cooperative other than equity capital. It belongs to others and must be returned to them in accordance with terms agreed to by owners of that capital. Much of it is acquired under specific conditions of rate of interest and terms of repayment. Also included in this kind of capital is that available because of normal delays in making settlements with patrons, paying taxes, or settling other currently payable items.

Those supplying this kind of capital do so as creditors and not as owners of the business. Cooperative management must decide how much creditor capital it should strive to get, the source of that credit, and what terms will be the most desirable to meet their situation.

Sources of Capital

Sources of capital for cooperatives may be classified as: (1) Direct investments by members, (2) nonmember investors (individuals), (3) operations of the cooperative, and (4) credit institutions.

As cited earlier, one part of financial management is to consider funds available together with terms under which they may be acquired. When applied to cooperatives this means that management needs to consider the sources available and develop a financing program which will best meet the needs of the cooperative.

Direct investments by members is a significant source as members have the responsibility for furnishing the bulk of capital requirements. First, members must provide equity capital. It is desirable for members to invest in equity capital approximately in proportion to the services they use.

In general the cooperative is dedicated to allocating savings to patrons according to their use (patronage) of the cooperative. Therefore, it is logical that financial burdens be shared in a similar manner; that is in proportion to services used.

Common stock and preferred stock are examples. Equity capital in nonstock associations usually takes the form of membership certificates, membership fees, or certificates of equity. A nominal rate of return may be paid upon equity capital, when justified with net savings.

However, most authorities feel that obligations to pay interest or dividends on equity capital should be kept to a minimum, especially for cooperatives during formative years. This is consistent with the idea that equity capital is ownership risk capital.

Members, also, may be a source of creditor capital by providing loan capital such as that evidenced by certificates of indebtedness or notes payable. Under these conditions cooperative management should consider them as regular loans, make interest payments, and specify maturity dates for the loans.

The cooperative should be just as concerned about meeting creditor capital commitments to members as they would be to any other holders of creditor capital.

Nonmember investors (individuals) are a source of capital but their investments are usually restricted to creditor capital. Some who are not members but occasionally use some service of the cooperative may be interested and willing to provide some capital on a loan basis, such as certificates of indebtedness or notes payable. Others in the community who are sympathetic toward the cooperative may also be willing to make a loan to the cooperative.

Preferred stock, because of its preferred position over common stock in dividends and in the event of dissolution, may attract investors, both members and nonmembers. This kind of equity capital merits consideration because it provides a means of spreading ownership among more people without giving up control.

Operations of the cooperative constitute an important source of capital for associations once they become established. It is possible to accumulate funds by means of a financing plan which often is called the revolving fund.[10] There are various kinds of revolving funds being used but certain elements are common to all.

Some method is needed to obtain capital from operations. This may be in the form of a retain (a stated amount per unit handled; that is, 2 cents per dozen of eggs marketed) or it may stem from net savings (a portion of the patronage allocation; that is, 25 cents of each dollar of patronage refunds). Capital accumulated always must be identified with accounts of individuals. During the initial stages the fund can be thought of as a sinking fund.

After the plan has been in effect for the planned period of time or when the desired amount of capital has been accumulated, the financing plan can become a revolving fund in the real sense of the word. Capital continues to accumulate as before, but at the same time some capital (probably that first accumulated) will be returned to owners.

When this stage is reached, capital is revolved because each year some flows into the fund while other capital is retired.

---

[10]For more information on revolving funds, including advantages and disadvantages and experiences of farmer cooperatives using them, see: Hulbert, Helim H.; Griffin, Nelda; and Gardner, Kelsey B. Revolving Fund Method of Financing Farmer Cooperatives. Gen. Rpt. 41. Farmer Cooperative Service, U.S. Dept. of Agr. March 1958.

The revolving fund provides a constant stream of capital and builds up investments held in proportion to members' use of the cooperative.

It also tends to keep financing identified with those using the cooperative's services.

Caution must be used, however, to avoid excessive annual withholdings from members and to limit the time capital is withheld to a reasonable period.

Often it is difficult to determine whether revolving funds are equity or creditor capital. Actually they may be either, for their classification depends upon the agreement made with members. For example, members may be given preferred stock as evidence of their investment. In that case, this stock would be classified as equity capital. However, if the cooperative makes a firm commitment -- for example designates a definite and final maturity date -- then this capital would have characteristics of creditor capital.

Most cooperatives find it desirable to handle capital in revolving funds as equity capital. Whenever revolving funds are used, management should be explicit as to the nature of the capital being handled and make certain it is well understood by members.

Credit institutions make up a fourth source of capital available to cooperatives. One or more of the following credit institutions are available to local cooperatives: (1) Banks for cooperatives, (2) commercial banks, (3) insurance companies, and (4) in designated areas facility loans may be obtained from the Area Redevelopment Administration of the U. S. Department of Commerce.

Credit agencies usually have different requirements for making loans. Cooperative management should become informed of the necessary requirements of each source and determine which agency can best serve the needs of their association. For example, most commercial banks are in a better position to make short-term loans rather than long-term ones.

Banks for cooperatives are well suited for making various types of loans to cooperatives. They were organized to serve the special credit needs of cooperatives on a cost basis. The banks for cooperatives stand ready to extend not only a line of sound credit but a sound advisory service to cooperatives as well.

Local conditions vary on availability of credit. Therefore, it is essential that alternatives be analyzed carefully to help the association get the capital it needs on the most favorable terms.

Analyzing Soundness

Ratios can be computed and used to appraise the soundness of a cooperative's finances. Their usefulness stems from the fact that relationships between financial items are examined. They are easily calculated and simple to understand. However, they do have shortcomings and should be used with care. Ratios are a type of average, and, therefore, subject to all the limitations of averages.

These ratios can be used in two ways. First, one might compare a ratio for a given cooperative with a standard ratio for other similar cooperatives. In this way management can determine obvious weaknesses and subsequently take corrective action.

Second, a ratio for a given cooperative for one time period can be compared with that ratio for another period. This type of ratio makes it possible to observe trends taking place in finances. Many who use ratio analysis find the latter more useful for managing finances.

A first step in determining a cooperative's financial soundness is to appraise its ability to pay obligations when they become due. Finances must be managed in such a way that assets become liquid (converted into a cash form) at the time and in the amount obligations become payable. If these conditions are not met, costs will increase and the cooperative's ability to remain in business may be jeopardized.

Ratios are available to assist in making this appraisal. One is the current ratio (current assets to current liabilities). It measures an association's ability to pay its current obligations (due within 1 year) with assets that can be converted to cash within 1 year (current assets). A ratio of 2 to 1 usually is considered desirable.

The quick ratio is a refinement of the current ratio and consequently is likely to be more useful. First, current assets are reduced by those current assets not easily converted to cash. Inventories, slow accounts, and notes receivable are examples. The adjusted current assets are divided by current liabilities to get this ratio.

The quick ratio is an excellent measure of a cooperative's ability to meet current financial requirements without losing a credit rating or without being forced to forego discounts for prompt settlement.

The member-equity ratio is a measure of long-term financial strength. It usually is stated as a percentage and is the percent which total member equity is of total assets.

This ratio reveals the "leverage" that member owners have in the financial structure and consequently in the control of the cooperative. Farmer members would need to own at least 50 percent of all assets to be assured of financial control. Most authorities hold that a member-equity percentage of 66 to 75 would be within desirable limits. A high ratio shows financial strength and stability, which is a desirable goal for financial management in cooperatives.

Analyzing Performance and Efficiency

Ultimately those responsible for financial management must appraise the operating efficiency of their cooperative and evaluate results. Earlier the importance of having stated objectives was stressed. Here is an opportunity to compare performance of the cooperative with established objectives.

We have discussed how it is difficult to make a complete appraisal of a cooperative's performance since net results of the cooperative and corresponding farming operations must be combined. However, much useful information for financial management can be gained by analyzing the cooperative business operation carefully.

Rate of return on member equity is obtained by stating net operating savings in percent of member equity. This ratio is a good measure of performance. It reflects the efficiency with which owners'

capital is being used in the cooperative. If prices to members continue unchanged, an increase in this rate of return would mean an improvement in performance.

Return on assets (net operating savings in percent of total assets) is another measure of overall performance in the cooperative. Assets represent capital committed to the business, and to be competitive a certain rate of interest must be obtained.

The year-to-year trend of return on assets is something which should be watched closely in financial management as it indicates the financial results being achieved by the cooperative.

Many other measures exist for evaluating performance of cooperatives with specialized activities and can be learned easily. It is the responsibility of the financial management to familiarize themselves with such measures and use them.

For example, return on sales (net savings per dollar of sales) is a valuable indicator of performance for a supply cooperative. Processing or manufacturing associations might use this ratio by computing net savings per unit processed or manufactured. Operating efficiency also can be determined by calculating costs per dollar of sales per unit processed or per unit manufactured.

Analyzing Uses of Capital

Earlier we stated that cooperative management has the responsibility for allocating funds among the various assets to be financed. Let us now consider how managers and directors might accomplish this goal. The task is one of allocating capital among the various needs so that available capital will be used to the best advantage.

Preparing a statement of sources and uses of funds is a valuable technique of financial analysis. The statement is easily prepared and is especially helpful for analyzing the balance between long- and short-term finances. Increases and decreases in balance-sheet items can be found by comparing the current balance sheet with that of the previous period.

Sources of funds come from: (1) Increases in liabilities, (2) increases in net worth, and (3) decreases in assets. Uses of funds stem from: (1) Decreases in liabilities, (2) decreases in net worth, and (3) increases in assets. Of course, total increases and total decreases must be equal.

A thumb rule of financial management is that long-term uses of funds should be financed from long-term sources. For example, many authorities advocate that, ideally, equity capital should be sufficient to finance fixed assets, including investments in regional cooperatives. However, it may be necessary initially to use a long-term loan that will gradually be replaced by equity capital as the loan is retired.

Also, short-term uses should be financed from short-term sources (probably liabilities).

A statement of sources and uses of funds will show amounts of changes and where they occurred. Equipped with this knowledge, management can take steps to keep finances in balance.

The matter of establishing control over accounts receivable is a critical

aspect of financial management in those cooperatives that make sales (such as farm supplies) to members. Unless care is taken, a cooperative may soon have too much of its assets invested in accounts receivable.

In addition, costs may increase because: (1) Often little or no interest is received directly from these accounts, and (2) some accounts may develop into bad debts and cause outright losses to the cooperative.

Accounts receivable to current assets ratio (accounts receivable divided by current assets) is a standard means of appraising the amount of current assets "tied up" in accounts receivable.

Accounts receivable turnover (net sales divided by accounts receivable) is a useful measure to reveal a combination of magnitude and liquidity of accounts receivable in the cooperative.

Along with these measures, it is necessary to determine the period of time individual member accounts have been in effect. This is called aging accounts receivable. When this summary has been made, it helps management appraise collection policies and determine how the real value of these assets should be appraised.

Inventory turnover (cost of goods sold divided by the inventory valued at cost) is an indicator of the number of times on the average during the year that the inventory was converted into sales. This ratio shows the need for keeping inventory items up to date and keeping the inventory properly stocked in relation to sales volume.

Guides for a Balanced Program

A final step in financial management is to develop a financial program. Consideration must be given to short- and long-term capital needs and to quantities of equity and creditor capital to be used. Still there are choices to be made among the four main sources of capital.

Here is a summary of guides that may be used in developing a financial program.

1. Members should be required to make equity capital investments approximately in proportion to services used by each.

2. Equity capital should be accumulated to equal investments in fixed assets (and possibly investments in other cooperatives). Initially some long-term loans might be used for this purpose but they should be replaced with equity capital as they are repaid.

3. Equity capital normally should be paid a return equivalent to a nominal interest charge when net savings are made.

4. Capital needed to finance noncash current assets at their yearly minimum level should come largely from members but may be in the form of creditor capital. Some of this logically could be held by nonmember investments.

5. Extra capital to meet seasonal peak requirements should be secured from credit institutions as short-term loans.

6. A policy should be adopted to retire equities of members no longer using services of the cooperative and to keep

equity capital in the hands of those who are using the cooperative's services.

Working with People

Many relationships between and among individuals and groups are involved in carrying on successful cooperative activities. A cooperative has already been defined as an association of persons. Consequently, relationships among members and especially between members and the association (as a business unit) become very important.

Other relationships to be considered are the employees' cooperative relationship and the relationship between the cooperative and the public.

The public has a right to know about cooperative developments, and a wise management supplies it with timely and factual information. As often stated in business circles, the "public" of a given business is made up of several "publics," rather than a single, "public."

Cooperatives may classify their "publics" into: (1) Employees, (2) members, and (3) the general public.

Cooperative management must concern itself with these relationships and develop policies to handle them in a satisfactory manner.

Employees

Personnel management probably is the most critical single phase of business management. Buildings, equipment, systems, and processes are needed in business operations, but they are passive and are productive only through people.

Despite current emphasis on automation, there is much truth to this concept of the importance of personnel. Having competent, well-trained, energetic, and satisfied employees cannot be overemphasized. "Employees" as used here means all personnel of the cooperative, except the manager, or general manager.

Local cooperatives vary extensively in the number of employees needed and the complexities of tasks to be performed. However, some basic elements of personnel management concern them all.

The manager usually determines matters of personnel management, since they definitely are in operations. The manager might handle all personnel details himself in small associations but delegate much of it to others in larger associations.

The important point is that the chief responsibility of personnel management is the manager's. However, some items of personnel management, such as hiring and dismissing department heads or making significant changes in the size of the work force, should have the board's consent.

Once personnel policy decisions are made, they should be carefully recorded and preserved in a personnel policy manual. All associations, large or small, should use such a manual, as written policies are necessary for sound personnel management.[11]

---

[11]For additional information useful in personnel management, see: Mullen, James J. and DeBoer, Lloyd M. Business Management of Frozen Food Locker and Related Plants. Pp. 13-26. MRR 258. Farmer Cooperative Service, U.S. Dept. of Agr. June 1958.

Job Analysis.--A step that must precede employing personnel is analyzing tasks to be performed. Job analysis means making a detailed statement of the duties of a job, describing how each is accomplished, and emphasizing the requirements an employee must meet to do the job satisfactorily.

Kinds of requirements are education, training, experience, physical requirements, skills, tools and equipment to be used, and personal qualities. The description should also set forth clearly the terms of employment, any supervision of others, and the name of the employee's supervisor. Once determined, these items should be recorded in a job description.

Sound organization requires dividing the total work into logical jobs, relating people to materials and equipment, establishing lines of authority and responsibility, and avoiding conflicts between employees and groups. The job description is an excellent tool for thinking through and developing a sound organizational structure for the cooperative.

If job descriptions have not been prepared previously, a good start can be made by preparing one when the first vacancy develops. Since a job must be described in some way before an employee can be hired, very little extra effort is required to prepare a complete written job description. Ideally, a cooperative should have a carefully prepared and detailed job description for each job in the operation.

Selecting Personnel.--Once job analysis has been completed, the cooperative can proceed to hire the kind of personnel needed. Many standard practices and techniques are used to determine an applicant's qualifications and to forecast his worth to the business. Cooperatives should use all effective techniques to select personnel.

Some special points regarding the selection of personnel for cooperatives should be observed.

First, the prospective employee should have a favorable attitude toward the cooperative form of business. The purposes and policies of the association should be explained to him carefully as should the principles, objectives, and commonly-used working procedures of cooperatives in general.

Any business has the right to expect loyalty of its employees, and it is especially important that cooperatives have loyal ones. This is not suggesting that only those who advocate and promote cooperatives should be employed. Instead, it is suggested unless one basically believes in the cooperative form of business, he likely will not make a good employee.

Second, the prospective employee should have the potential of representing the cooperative favorably. Cooperative employees must recognize the membership interest of those they serve. Most patrons are owners and, therefore, ordinarily tend to have greater interest in the business. Consequently, a special obligation is placed upon employees. Studies have shown that employees are one of the most important sources from which members get information about the cooperative. To a great extent the cooperative's image will be made by its employees.

Third, cooperatives should avoid nepotism. Nepotism is defined as favoritism shown to close relatives--bestowal of patronage by reason of relationship. A special problem often faced by local

cooperatives is whether or not relatives of the board, manager, or others in management positions should be employed.

Obviously there is no merit in employing a person merely because he is a relative of a key person in the cooperative. Some argue that well-qualified relatives should not be barred automatically. However, difficult problems and misunderstandings often can be avoided by having a policy that would prohibit nepotism. If relatives are hired, they should not work under own relatives.

Cooperatives need to seek applicants, check references, and conduct interviews. Cooperatives that make special efforts to attract exceptionally well-qualified people usually are well rewarded for their efforts. Often business schools, employment agencies, and agricultural universities prove to be good sources of prospective employees.

To have some employees who have qualifications for more advanced positions than ones currently held can be of much value to an association.

Employee Compensation.--Compensation policies are crucial, since they affect the kind of applicants attracted, the association's ability to hold employees, and motivation for doing high-quality work. Authorities maintain three main aspects to compensation policies are: (1) Level of pay, (2) structure (relationship of pay with that of other jobs), and (3) provision for increasing pay as employees become more efficient.

Cooperatives should pay at a level comparable with those doing similar work in other businesses located in the same area. Low pay scales usually repel superior workers and cause problems when used over a period of time. Determining the community's prevailing wage usually presents no real difficulty. Often the more serious problems are establishing the wage structure and deciding upon merit increases. Differentials in pay between workers commonly are found to be more important than the actual level of pay.

Two guides useful in developing the wage structure are: (1) Provide equal pay for equal work, and (2) allow fair differentials for given differences in job requirements.

Once an employee has increased his usefulness to the cooperative by experience and training, he is entitled to increased pay. Management must recognize the importance of sound compensation policies and take whatever steps are necessary to develop them and keep them up to date.

Cooperatives face a special employee problem because they are owned and controlled by members. Unlike other kinds of businesses an employee of a farmer cooperative cannot expect someday to take over as an owner of the business or anticipate becoming a salaried director. Furthermore, he usually does not have the prospect of being awarded company stock as an incentive for superior work. These are added reasons why a cooperative should pay wages that are at the competitive level or higher.

Many cooperatives use incentives as a part of total employee compensation to make cooperative employment attractive. Some argue that extra pay, such as a bonus, causes an unjust reduction in patronage refunds rightfully belonging to members. However, the more proficient the employees, the more efficient the

operation -- and the larger the patronage refunds.

Certainly employees giving faithful and efficient service to the cooperative should be rewarded -- whether in the form of wages, straight commission, or some combination of wages and incentives.

Fringe benefits, such as retirement annuities, insurance, and vacations logically can be sound features of a cooperative's compensation program. A national study of incentives used in farmer cooperatives revealed three-fifths of those reporting were using one or more incentive plans.[12]

Other Personnel Management Matters.--Personnel supervision is handled by the manager in many local cooperatives. Because of number of employees or the specialized nature of their work, the manager may delegate some supervisory responsibility to subordinates. Whether these responsibilities are borne by the manager or shared, a number of specific functions must be performed.

The supervisor must plan the work of others, delegate responsibilities and authority, set performance standards (with the concurrence of fellow workers), train workers, review performance, set up a grievance procedure, and provide leadership to workers.

Whenever more than one person is needed to accomplish a job, it becomes necessary to develop plans and methods for the group effort. To do this successfully, the manager must see that: (1) Each person has only one supervisor, (2) no one supervisor attempts to control the work of too many individuals, (3) each person is given a specific job to do, and (4) responsibility and authority are delegated at all levels.

Sound personnel management requires that all positions (especially key ones) be manned at all times with competent personnel. To satisfy this condition, the cooperative must train personnel to do their own jobs better and to learn new jobs as well.

A desirable arrangement is to develop an alternative for each job in case the regular employee is absent or resigns. Much of the training needed can be furnished by the cooperative's own personnel. In most areas, regional cooperatives have regularly scheduled schools designed to meet such needs and often welcome non-affiliated locals to them.

Members

Members constitute the second special group of persons important to the cooperative. Earlier we stated that a cooperative is an association of persons (members). On the surface it may sound strange to suggest that members should be concerned with how members are treated. No double talk is intended. Instead such statements emphasize the uniqueness of cooperatives in this respect.

Why Member Relations Are Important.--The term "member relations" has been coined to describe relationships between members and key management personnel of the cooperative. Of concern here are those relationships between

[12] Griffin, Nelda. Employee Incentive Plans in Farmer Cooperatives, 1957. Gen. Rpt. 62. Farmer Cooperative Service, U.S. Dept. of Agr. June 1959.

Griffin, Nelda. Employee Incentive Plans--Case Studies of Five Farmer Cooperatives. Gen Rpt. 104. Farmer Cooperative Service, U.S. Dept. of Agr. August 1962.

members and the corporate body, as represented by the manager, other employees, and the board of directors.

Member relations is a special term used to describe a relationship unique to cooperatives. Membership in a cooperative denotes rights of ownership and control and entitles members to the services of the cooperative. The unique aspect is found in the fact that all three rights (ownership, control, and patronage) are held by the same individuals. The member is a patron served by the cooperative; he also is the ultimate source of power from which the board derives its authority.

Shareholders of ordinary business corporations may be considered members of the corporation but only from the standpoint of ownership and perhaps control. It is coincidental when these members use the corporation's business services. Contrary to this, the sole reason for the cooperative's existence is to perform services for its members.

Although most cooperatives do not refuse nonmembers' patronage, their primary concern must be for members' patronage. Therefore, establishing and maintaining proper relations with members is of paramount importance. Actually if a cooperative cannot get the patronage of its own members, it cannot possibly achieve its objective.

Cooperatives must be sensitive to the desires of all members. This is essential because all members have voting rights and because participation on the part of any members is voluntary. Most will agree that widely held control is an advantage of the cooperative form of business. Yet, unless members are well informed and are willing to participate responsibly, such an arrangement may ruin the cooperative. Membership participation creates interest, enthusiasm, and loyalty that cannot be achieved in any other way.

Membership in a cooperative usually is held by the farm operator, who is the object of typical member relations programs. However, others in the family unit are involved since the entire family stands to gain or lose depending upon the outcome of the cooperative's operations.

Often cooperatives single out others in the family unit and develop special membership programs for them. Many cooperatives have found programs for farm women[13] and farm youth[14] effective means of developing sound member relations.

Improving Member Relations.--Membership relations in any given cooperative may be good or poor. The objective of a member relations program is to improve members' understanding and to increase their participation in the cooperative.

To be successful, a cooperative must have members who are well informed on: (1) The cooperative form of business and how it operates; (2) members' responsibility in financing, patronizing, and managing the cooperative; and (3) benefits that have been derived and those that logically can be expected. Emphasis should be placed continually upon their own cooperative and their relationship with it.

[13] LeBeau, Oscar R. and Heckman, John H. How Women Help Their Farmer Co-ops. Cir. 15. Farmer Cooperative Service, U.S. Dept. of Agr. June 1956.

[14] LeBeau, Oscar R. and Heckman, John H. Cooperative Business Training for Farm Youth. Cir. 1, Farmer Cooperative Service, U.S. Dept. of Agr. January 1954.

Information is the heart of any member relations program. First, there must be a flow of information from the corporate body to members. Second, members must have an opportunity to convey their wants and opinions to the corporate body. There must be a means for each to initiate the flow of information as well as react to information received. Such a two-way flow of information is an essential part of an adequate member relations program.

But more than information is needed to insure member participation and support. The cooperative must be basically sound and in a position to produce economic benefits for members. Once these conditions are met, a program to increase the two-way flow of information can be expected to improve member relations.

Getting member participation requires planning and a great deal of effort. Boards and managers must have a desire for members to participate and an understanding of what is required to keep them active in their cooperative. Management must function forcibly in the area of member relations if the association is to get full participation from its members.

It is a challenge for cooperatives to develop appropriate means for providing the two-way flow of information. Many techniques have been developed, but they can be grouped under the following major headings: (1) Meetings, (2) periodic reports, (3) member participation, and (4) community activities.[15]

The General Public

The third "public" with which cooperatives need to be concerned might be called the general public -- the persons not associated with the cooperative. Whereas, member relations deal with internal relations, public relations pertain to external relations. This public includes nonmember farmers and those in other businesses as well as citizens in general.

Public Understanding and Acceptance Is Essential.--Management of cooperatives must be conscious of how others view their associations. The goal of a public relations program is to create a favorable impression on others. Sometimes cooperative leaders fail to appreciate the necessity of taking positive steps in their relations with the general public.

A cooperative's public relations are important for several reasons. For years it has been the policy of the Federal Government to encourage the organization and development of farmer cooperatives. Federal and State laws recognize distinctions between cooperatives and other businesses.

In general, these actions have been based on the belief that farmer cooperatives are desirable and serve the public interest. The public must be made aware of the special nature of farmer cooperatives and how they serve the public interest. Therefore, farmer cooperatives are in a unique position in relation to the

[15] LeBeau, Oscar R., Membership Practices of Local Cooperatives, General Report 81. Farmer Cooperative Service, U.S. Dept. of Agr. July 1960.

LeBeau, Oscar R., Suggested Steps for Improved Member Relations, Information 12. Farmer Cooperative Service, U.S. Dept. of Agr. June 1960.

LeBeau, Oscar R., and Hyre, French M., Making the Most of Your Co-op Annual Meeting, Circular 22. Farmer Cooperative Service, U.S. Dept. of Agr. October 1957.

LeBeau, Oscar R., and Heckman, John H., Patrons Appraise Cooperative Relations. Circular C-140. Farm Credit Administration, U.S. Dept. of Agr. May 1951.

Rust, Irwin W., Making Member Relations Succeed, Information 32. Farmer Cooperative Service, U.S. Dept. of Agr. February 1963.

general public, and attitudes regarding cooperatives held by the general public are important.

Cooperatives should be aware that groups within the general public have formed opinions of their associations. They also need to recognize that those opinions are being modified continually. It is for the best interests of cooperatives that the public's opinions be based upon facts and that they be as favorable as possible.

An effective program of public relations can attract nonmember farmers into membership. For this purpose, information on objectives of the cooperative, services performed, and results achieved would be helpful.

Of course, more should be done to attract new members than can be accomplished in a public relations program. However, in carrying out a public relations program in a community, appealing to new members could be one of the immediate tangible benefits.

A cooperative with good public acceptance by its community can expect an indirect benefit. Most people want to be accepted by others and want others to think well of them. Often people are judged by the kinds of groups and institutions with which they are identified.

If a cooperative has an unsatisfactory image in the community, it probably will create some apprehension in the minds of members who, as a result, will restrict their patronage. Assuming an improvement in public relations could correct the image, increased patronage could be a result.

Improving Public Relations.--It has been said that good public relations is, first of all, living right, and then getting credit for it.

This slogan is especially meaningful, since it suggests that good performance on the part of the cooperative is a necessary prerequisite to good public relations. Furthermore, it implies that no amount of effort and expenditures can develop desirable opinions over a period of years unless the cooperative is deserving.

Sometimes it is argued that a local cooperative is too small to justify a public relations program, and that small cooperatives do not have much impact on public opinion, anyway. No cooperative, large or small, can afford to ignore public attitudes.

Local cooperatives should be aware that attitudes prevailing in their communities toward cooperatives will be molded almost entirely by their organization. Also, if anything is to be done to improve understanding and attitudes in those areas, it will have to be done by the cooperatives located there.

Local cooperatives are confronted with some practical limitations in dealing with the public beyond their community limits. However, organizations are available to help with public opinion in other geographical areas such as State cooperative councils or associations. These organizations disseminate factual information to improve the cooperative image in that State.

Several national cooperative organizations, controlled and financed by local and regional cooperatives, help get cooperative information to nationwide audiences.

They are the American Institute of Cooperation, The Cooperative League of the U. S. A., National Council of Farmer Cooperatives, National Federation of Grain Cooperatives, National Milk Producers Federation, and National Rural Electric Cooperative Association.

Farmer Cooperative Service of the U. S. Department of Agriculture has the responsibility for disseminating information on cooperative principles and practices. In carrying out this responsibility, FCS plays an important role in getting facts to the public which are useful for developing favorable public opinions on cooperatives.

A cooperative that is serious about improving its public relations can find many opportunities for doing so. But to be most effective much planning is necessary.

In addition, management must be willing to allocate time and resources needed to do the job. Specifically, it is the responsibility of the manager, with the active support of his board, to develop and carry out public relations programs.

Experience has revealed many techniques useful for getting factual information to the general public.[16] The important thing is for cooperative management to use those techniques best suited to do the job well. All who are a part of management should use a positive approach and work aggressively to develop favorable attitudes for cooperatives in their sphere of influence.

MANAGEMENT EVALUATION AND IMPROVEMENT

"The first and most important job of a manager is to seek continuously for improvement."

This is the way a president of a large and successful corporation viewed the urgency of probing for and making improvements.

This kind of thinking can be used to advantage by cooperatives and might be stated as, "The first and most important job of cooperative management is to seek continuously for improvement."

Any program of improvement raises a question of just where to start. For improving cooperative management, it would seem the answer is quite clear. Any major improvement in the management of farmer cooperatives will have to be self improvement -- for several reasons.

First, improvements are needed in management skills in associations that currently are operating.

Second, it is not realistic to assume cooperatives can always go into the

[16] Abrahamsen, Martin A. Planned Public Relations--in Modern Cooperative Business, Information 10, Farmer Cooperative Service, U.S. Dept. of Agr. July 1959.

News for Farmer Cooperatives. Public Relations Inevitable. Farmer Cooperative Service, U.S. Dept. of Agr. Reprint 11, Section A. May 1951.

News for Farmer Cooperatives. New Ideas on Public Relations. Farmer Cooperative Service, U.S. Dept. of Agr. Reprint 57. November 1953.

marketplace and immediately secure other and better management personnel on any large-scale basis.

It already has been emphasized that cooperative directors, for the most part, must be selected from the association's own field of membership. Therefore, any program for improving the directors' part of management must center around upgrading talent that currently is available to the cooperative.

Another complicating factor is that business in general is experiencing a scarcity of capable and experienced hired management. Thus, it seems unwise for farmer cooperatives to ignore what they already have and seek elsewhere to fill their needs. What is needed is a program to improve management personnel that cooperatives do have and to develop those having the potential for management positions.

Evaluating Management

The cooperative's operating statement, balance sheet, and financial audit are useful devices to determine results that have been achieved in business activities during the accounting period. Wise management will use such reports (together with supporting records) to evaluate progress or lack of progress. Careful study of these materials will provide insights into improvements that can be made in operating the business.

Just as there is need for an annual financial analysis to improve business operations, there also is need for a periodic management analysis, if management is to be made more effective.

A management evaluation can be a first step for improving the functioning of management. In a sense this means taking an inventory of management as it currently is functioning. Since the cooperative solely is responsible for its management, primary emphasis needs to be given to self-improvement.

Earlier it was pointed out how management may be considered from two viewpoints: (1) The who aspect -- that is, people responsible for management; and (2) the what aspect -- that is, functions that are involved in managing. The two need to be integrated when it comes to evaluating the effectiveness of total management.

Who should make the evaluation? Which management personnel should actually appraise the functioning of the cooperative's management team? The manager and the president of the board are key persons in management and both are needed in making an evaluation. One possibility is to have an evaluation committee consisting of the manager, selected board members (including the president), and key staff members.

Two items should be remembered when selecting committee personnel. First, experienced individuals are needed who have insight into the aspects of management being evaluated. Second, since the main purpose of having an evaluation is to effect needed improvements, personnel should be chosen that have authority to put needed changes into action.

How often should a management evaluation be made? This is another question that needs to be resolved. Obviously no one answer can be given for all associations. Once a year would seem suitable under ordinary circumstances, but the

evaluation might be needed more frequently in rapidly changing situations. It would most certainly be undesirable for a cooperative to operate for more than a year without a management evaluation.

A form (worksheet 1) has been prepared and is included here to help management personnel evaluate its own performance.

Questions included focus attention on crucial elements of management. They are grouped under five main headings. Four of these correspond to the major functions of management which emphasize the functional aspects of management. The fifth category, the cooperative management team, contains questions pertaining to the who part of management. Many of these deal with the division of responsibility, a matter of particular concern in managing cooperatives.[17]

Improving Management

What benefit can be derived from a management evaluation? There is little, if any, merit in making an evaluation merely to establish a score on how well management has been functioning. Instead, the chief value comes from pinpointing areas where management needs to be improved.

Scoring in worksheet 1 is designed to attract attention to short-comings. Once problems are detected, management can take steps to solve them. Unless there is an immediate and vigorous effort to effect improvements, the evaluation will have been of little or no practical value.

[17] News for Farmer Cooperatives. Reprint 52. Good Management Key to Co-op Success. Farmer Cooperative Service, U.S. Dept. of Agr. Pp. 4-8. (Articles by Dick Carlson.)

As stated previously, the evaluation committee makeup should include those who have the authority to act. This arrangement will expedite correction of deficiencies uncovered in the evaluation.

Management should not be discouraged if their evaluation reveals improvement is needed in many of the 30 items included. Attention need not be given to all phases at once. Instead management might decide that certain ones are the most critical and then proceed to correct them. Priorities might be set up for remaining ones so improvements could be handled in an orderly manner.

A thorough management evaluation focuses attention on what needs to be improved. Only in an indirect manner does it imply how improvements are to be made. Often questions are so worded that desirable procedure is inferred. However, more information than this is needed to guide desired changes.

Any cooperative interested in improving its management should be willing to do what it can to help itself. There must be a willingness to allocate time of personnel involved and to incur some expense for training. Most associations have one or more experienced persons qualified to conduct their own training sessions.

Many agencies are available to assist with management training. Some are willing to advise and to provide reference materials. Others may go so far as to offer courses and hold conferences on management subjects.

As has been mentioned before, Farmer Cooperative Service of the U. S. Department of Agriculture provides a wide range of materials on management. In addition,

Worksheet 1. Evaluating Management of a Cooperative

Key questions to ask:	1	2	3
Planning			
1. Are the objectives of the cooperative clear-cut, up-to-date, understood and taken into account in current operations?			
2. Are results of research studies used for planning, and is management aware of research available from regional cooperatives and State and Federal research agencies?			
3. Have policies been formulated covering regular recurring operations on which decisions have to be made from time to time?			
4. Are operations adequately planned on both a long-range and a short-term basis in harmony with objectives?			
5. Have adequate analyses, which portray the potential business volume or service requirements of the cooperative over the next several years, been completed?			
Organizing			
1. Is there a clear-cut organization plan relating personnel and facilities consistent with tasks to be accomplished?			
2. Are there detailed job descriptions for executives and supervisors making clear their responsibilities, authority, and relationships?			
3. Are the functions, authority, and relationships of the various functional units clearly established?			
4. Are qualified persons selected against position requirements and properly assigned in the organization and adequately paid?			
5. Are personnel requirements for key positions projected far enough ahead (3 to 5 years), and are qualified replacements available as needed?			

Legend: 1--good, no improvement needed, 2--fair; some improvement needed; and 3--poor or lacking, much improvement needed.

Worksheet 1. Evaluating Management of a Cooperative (con.)

Key questions to ask:	1	2	3
Directing			
1. Are work assignments fair and directions clear and complete? Do they tell why as well as what?			
2. Are positions evaluated and performance appraised objectively and periodically?			
3. Are working conditions conducive to maximum effort?			
4. Are standards of performance--or results--known? And accepted?			
5. Are clearly defined channels of communication--down, up, and across organization lines--kept open and used consistently?			
Controlling			
1. Does hired management control by making effective use of clear-cut policies and standards of performance to guide subordinates in making required decisions?			
2. Does hired management exercise control by clearly delegating adequate authority so that each subordinate knows when he can decide without incurring displeasure?			
3. Does the board require and make appropriate use of an external audit?			
4. Are methods of operation critically reviewed periodically by qualified persons?			
5. Is an operating budget prepared and used to check current performance?			

Legend: 1--good, no improvement needed; 2--fair, some improvement needed; and 3--poor or lacking, much improvement needed.

Worksheet 1. Evaluating Management of a Cooperative (con.)

Key questions to ask:	1	2	3
Co-op Management Team			
1. Does the corporate structure clearly indicate the ultimate source of authority and the respective responsibilities of members, board of directors, and hired management?			
2. Are the respective functions and responsibilities of board and hired management clearly distinguished?			
3. Is the manager free to make recommendations to the board according to his best judgment?			
4. Does the manager present matters, including regular reports, to the board in the most effective form for their consideration and decision?			
5. Does the board delegate responsibility and corresponding authority to the manager?			
6. Does the board let the manager take appropriate action in selecting, directing, disciplining, or releasing staff members?			
7. Does the board support the manager appropriately when he functions within established policies?			
8. Does the management team devote attention to member and public relations and promote programs for improving them?			
9. Do board members maintain appropriate balance between representing special localized interests and on the other hand thinking in terms of the enterprise as a whole?			
10. Do all parts of the management team recognize their responsibility for continuously seeking to improve themselves to do their jobs?			

Legend: 1--good, no improvement needed; 2--fair, some improvement needed; and 3--poor or lacking, much improvement needed.

regional and national cooperatives, State universities, banks for cooperatives, and State cooperative councils can be valuable sources of assistance.[18]

Of chief importance is that management of local associations must sense the need of making improvements and then seek out those sources that can be the most helpful in meeting their needs.

A Final Check for Good Performance

As a final step in evaluating and improving management, the local association might ask the following 11 questions. Management should continue its program of improvement until all can honestly be answered in the affirmative. These questions are:[19]

1. Do we have a first-class plan of organization?

2. Do we have well-established operating policies?

3. Do we have an alert, capable board of directors?

4. Do we have able, determined executives -- the best men for each job?

5. Is our personnel competent, well-trained?

6. Do our members know what it's all about and have a voice in decision making?

7. Does the community respect us and have confidence in us?

8. Are our facilities attractive, adequate, and well-planned?

9. Do we have sufficient membership capital to do the job?

10. Are our accounting methods modern and up-to-date?

11. Do we have a research program to keep us abreast of the times?

---

[18] For information on management training, including agencies furnishing it and kinds needed, see: Volkin, David, and Griffin, Nelda. Management Training Among Farmer Cooperatives. General Report 65. Farmer Cooperative Service, U.S. Dept. of Agr. June 1959.

[19] Knapp, Joseph G. Good Management Key to Co-op Success. News for Farmer Cooperatives. Reprint 52. Farmer Cooperative Service, U.S. Dept. of Agr.

U.S. GOVERNMENT PRINTING OFFICE : 1964 O - 730-650

Other Publications Available

Legal Phases of Farmer Cooperatives, FCS Bulletin 10.

Farmer Cooperatives . . . Farm Business Tools. AIB 275. Beryle Stanton.

Business Management of Frozen Food Locker and Related Plants. Marketing Research Report 258. James J. Mullen and Lloyd M. DeBoer.

Methods of Financing Farmer Cooperatives, General Report 32. Helim H. Hulbert, Nelda Griffin, and Kelsey B. Gardner.

Management Training Among Farmer Cooperatives, General Report 65. David Volkin and Nelda Griffin.

Bylaw Provisions for Selecting Directors of Major Regional Farmer Cooperatives, General Report 78. Helim H. Hulbert, David Volkin, and Nelda Griffin.

Directors of Regional Farmer Cooperatives--Selection, Duties, Qualifications, Performance, General Report 83. David Volkin, Nelda Griffin, and Helim H. Hulbert.

Director Committees of Farmer Cooperatives, General Report 85. Nelda Griffin, Helim H. Hulbert, and David Volkin.

Criteria for Evaluating Dairy Cooperatives, FCS Bulletin 14. Stanley F. Krause and Joseph M. Cowden.

Employee Incentive Plans--Case Studies of Five Farmer Cooperatives, General Report 104. Nelda Griffin.

Trends in Growth of Farmer Cooperatives, 1950-60, General Report 110. Kelsey B. Gardner and Anne L. Gessner.

Managing Farmer Cooperatives, Educational Circular 17. Kelsey B. Gardner.

A copy of each of these publications may be obtained upon request while a supply is available from--

Farmer Cooperative Service
U. S. Department of Agriculture
Washington, D. C. 20250